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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	)	
	)	
Implementation of the	)	CC Docket No. 96-128
Pay Telephone Reclassification	)	
and Compensation Provisions of	)	
the Telecommunications Act of	)	
1996	)	

COMMENTS

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January 7, 1998

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COMMENTS

MCI Telecommunications Corporation (MCI) hereby supports AT&T's Petition for Reconsideration of the Commission's Payphone Order in its entirety and opposes the Petitions for Reconsideration filed by the RBOC/GTE/SNET Payphone Coalition (the Coalition), the American Public Communications Council (APCC), and Peoples Telephone Company, Inc. (Peoples Telephone).

I. THE COMMISSION SHOULD ADOPT AT&T'S PETITION IN ITS ENTIRETY

As demonstrated by AT&T, compensation for access code and subscriber 800 calls should be determined using a bottom-up, cost-based approach based on forward looking efficient costs, as this methodology will establish "fair" compensation, as required by the Act, and it will lead to efficient payphone rates and the efficient deployment of payphones.[1] Moreover, the Commission's reasons for rejecting this approach are without merit. Specifically, it is not necessary to determine compensation based on a marginal payphone in order to encourage the greater deployment of payphones because the market already provides a mechanism to support "inefficient" payphones through "semi-public payphones" and the Act provides support for "public interest payphones." In addition, as demonstrated by AT&T, rate regulation is appropriate where competition does not constrain prices as in the case of payphone compensation.

Furthermore, as demonstrated by AT&T, the Commission's market-based compensation scheme is flawed and must be reconsidered. As an initial matter, the Court did not endorse the Commission's market based approach to setting compensation for access code and subscriber 800 calls. In any event, the Commission's market-based approach, in which compensation for subscriber 800 and access code calls is determined by subtracting coin costs from the market rate for a local coin call is irrational because local coin calls and coinless calls are not the same market. As stated by AT&T, "the fact that these two types of calls are 'independent goods' means that the <u>rates</u> for coin calls provide no basis for calculating the <u>costs</u> of coinless calls." [2]

In addition, the Commission's implementation of its market-based approach is fundamentally flawed. Specifically, the Commission erred in relying on PSP cost data only and ignoring LEC data, including data provided by Sprint. Moreover as demonstrated by AT&T, the

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[1] The Commission pseudo "bottom-up" analysis in the Remand Order is insufficient in part because it fails to consider efficient costs of all payphone providers.

[2] AT&T Petition at 7.

Commission made several errors in calculating the avoided costs of coinless calls. For example, the Commission erred in beginning its market rate minus cost analysis at the highest market rate; the Commission failed to deduct the profit on avoided costs; and the Commission assigned an inadequate amount to avoided costs for local call completion. Finally, the Commission must recalculate the cost of transmitting unique payphone coding digits in light of USTA's admission that its original data-- on which the Commission relied-- is grossly inaccurate.

II. THE COMMISSION MUST REJECT THE ARGUMENTS OF THE PSP PETITIONERS

The arguments raised by the RBOC Coalition, APCC and Peoples Telephone, all of which argue that the Commission underestimated the cost of providing access to subscriber 800 and access code calls, must be rejected as without merit. These Petitioners all argue that the capital cost of the coin mechanism is not an avoidable cost because a PSP would not place a phone without a coin mechanism.[3] According to the Coalition, "PSPs would put in no payphone at all if the coin mechanism and coin box costs could not be recovered." [4] Thus, Petitioners argue that there should be no offset to the local coin rate for the costs associated with the coin mechanism in calculating compensation for access code and subscriber 800 calls.

Coin mechanism and coin box costs clearly are only used in connection with coin calls and, therefore, they are avoidable costs because they are not common to all functions of the payphone. In addition, contrary to the assertion of the Coalition, the Commission's decision does not preclude the recovery of the coin mechanism and coin box costs. Rather, it merely requires

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[3] Coalition Petition at 10.

[4] Coalition Petition at 10 (emphasis in original).

that these costs be recovered from coin calls-- which is entirely feasible and appropriate since the rate for local coin calls has been deregulated.

The Coalition also argues that the Commission's figures for coin phones versus coinless phones are not accurate. It argues that the Commission erred in using the AT&T 11A payphone as the benchmark for the cost of a coinless phone; that the cost of a coinless phone should have been subtracted from the cost of an average coin payphone-- which is a dumb payphone; and that coin mechanism costs should have been allocated based on average call volumes rather than marginal call volumes.

With respect to the Coalition's argument challenging the estimated cost of a coinless phone, the Commission based its estimate on the best available data on the record, which was provided by AT&T. Even now, the Coalition's "data" is nothing more than totally unsupported and unverifiable price quotes from unnamed vendors for payphones that are not in service. Thus, the AT&T data remains the best and only data on the record which reflects the current payphone market.

As indicated above, compensation should have been based on the costs and call counts for an efficient payphone. In any event, since the Commission's compensation calculation is based on a marginal phone, the coin mechanism costs should be allocated based on marginal call volumes rather than average call volumes.

As for the Coalition's argument that the cost of "dumb" payphones should be included in the Commission's calculation, the costs of all payphone providers should be considered in the determination of the appropriate amount of payphone compensation-- not just non-LEC PSPs-- for all aspects of the calculation. Thus, all data concerning the cost of LEC payphones, not just the cost of "dumb" payphone equipment, should have been considered by the Commission. This also applies to the Coalition's argument that the Commission erred with respect to its findings concerning line costs because it failed to consider LEC data.

The Coalition, APCC and Peoples Telephone argue that the Commission erred by ignoring bad debt and collection costs in determining payphone compensation. In their Petitions, APCC alleges that bad debt equals 2.8 cents per access code call and Peoples Telephone alleges that it equals 1.2 cents per call. APCC's data covers a five year period when there was no compensation for access code and subscriber 800 calls and, therefore, this cost cannot be attributable to such calls. And, Peoples Telephone's data covers a nine month period ending September 30, 1997, before per-call compensation was in effect and during which period payphone compensation was vacated. Accordingly, neither Petitioner has presented sound data concerning an amount attributable to bad debt charges for per-call compensation for access code and subscriber 800 calls.

APCC and the Coalition argue that the cost of ANI ii digit upgrades should be assigned to access code and subscriber 800 calls only, not all calls, because the upgrades are "being implemented solely for the purpose of per-call compensation and tracking on subscriber 800 and access code calls."[5] This statement contradicts earlier statements by the Coalition that some LECs are implementing ANI ii upgrades to comply with the Commission's requirement in the originating line screening proceeding. Moreover, that proceeding clearly establishes that unique payphone ANI ii digits will assist PSPs in preventing charges for fraudulent calls, and are not for the sole purpose of payphone compensation. In any event, ANI ii digits will be transmitted with

[5] The Coalition Petition at 19.

every call from a payphone and, therefore, it is appropriate to apportion the cost of implementing payphone digits to all calls from payphones.

Finally, the Coalition asserts that the Commission was "wrong" to refuse to take demand conditions into account and apply the inverse elasticity pricing rule it proposed.[6] The Coalition believes that the elasticity estimates supplied by their economic advocate, Dr. Jerry A. Hausman, are accurate enough to provide some guidance to the Commission in setting payphone compensation rates. While MCI opposes the use of inverse elasticity pricing rules for setting compensation rates, the persistence of the RBOC Coalition in promoting their flawed approach encourages at least brief comment on the validity of the RBOC Coalition's proposal. Contrary to the Coalition's claims, the elasticity estimates and pricing rule proposed by Dr. Hausman[7] -- correctly rejected by the Commission -- are miscalculated and even more fundamentally flawed. First, the demand elasticity for toll service is formally unrelated to the demand for placing a long-distance call from a payphone. Hausman, moreover, did not choose to use the accepted demand elasticity for local telephone service (-0.05) as a proxy for coin calls (a value which does not fit well with his analysis) though this figure is no more or less related to payphone services than the toll service elasticity. The Commission cannot be expected to take seriously Dr. Hausman's anecdotal estimate of the demand elasticity for coin calls.

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[6] As demonstrated, local calls and coinless calls are not the same market and the independence of coin and non-coin service markets is supported by the Coalition's own analysis. If coin and non-coin services were related in consumption, then the Coalition's inverse elasticity pricing rule would take into account not only the own-price elasticities of demand for these services but also their cross-price elasticities of demand. See, e.g., Jean Tirole, The Theory of Industrial Organization (1988), p. 70. In any event, the Coalition's elasticity analysis is flawed.

[7] The Coalition Comments, filed August 26, 1997, Declaration of Dr. Hausman at 10-17.

Furthermore, there is a fundamental lacuna in Dr. Hausman's approach. Use of market elasticity estimates of interstate long-distance as proxies for elasticities of the individual firm [8]is, as economists such as Alfred Marshall (1842-1924) well knew, a gross underestimate of any individual firm's own-price elasticity. (The elasticity for Miller Lite beer is always going to be greater then the elasticity of demand for beer). For example, Hausman uses an estimate of -0.723 as the elasticity of interstate long distance demand in his calculations. He then uses this elasticity in calculating the price mark-up for the individual firm. However, the inverse elasticity rule that Hausman proposes is derived from the equilibrium conditions of the individual firm and is dependent upon the firm's own-price elasticity. Use of the market value grossly underestimates the firm elasticity value which, in most markets, will be many times the value of the market elasticity.[9] On its own terms, Hausman's argument would be completely reversed if the firm elasticity is only six and one-half times greater than the market elasticity. This is by no means a strenuous condition as the analysis presented by Professor Clement Krouse in his rejected text Theory of Industrial Economics.[10]

Dr. Hausman is also quick to reject the econometrically estimated coin elasticity estimate provided by the E-Group study (-0.31). Hausman's criticisms of the E-Group report suggests that he is not familiar with the basis of that study. First, contrary to Professor Hausman's

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[8] Id. at 13.

[9] Dr. Hausman's proposed rates and marginal cost estimates imply a price cost margin for both coin calls and access 800 calls in excess of 0.88. This price cost margin exceeds that of "one of the highest margin legal businesses in the U.S." - the margin on switched access services (Regional Bell Operating Companies - Opportunities. While Danger Calls, Salomon Brothers, January 1996, p.20).

[10] Clement G. Krouse, Theory of Industrial Economics (1990), p. 425.

description, the E-Group study is not a demand study in the ordinary sense, but rather a study of equilibrium entry by payphone operators. Using a new, "ordered entry" approach that, unlike Dr. Hausman's analysis, explicitly recognizes that payphones enjoy locational monopolies, and that the quality of market locations declines under rational entry, the E-Group methodology allows a direct estimate of the supply of payphones under competitive entry conditions.[11] The E-Group approach assumes that payphones are installed through time at all profitable locations. The profitability of any given location depends on the demand for services of the phone and the remuneration those services command. Thus, the public's demand for payphone services is estimated indirectly.

Second, Dr. Hausman's claim of simultaneity bias in the E-Group study is very peculiar. Contrary to Dr. Hausman's apparent belief, coin rates used in the E-Group study were collected prior to the deregulation of those prices and are administratively determined, fiat prices. Thus, prices used in the E-Group study were not determined by market equilibrium where quantities supplied and demand adjust towards equality, but instead were determined politically outside of the market. Consequently, the analysis of Professor Haavelmo cited by Dr. Hausman is inapplicable to this model. Finally, Dr. Hausman is also incorrect when he asserts that E-Group

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[11] Indeed, an essential key to understanding the payphone market is the recognition that location providers will extract rents that are then passed on to consumers. This transfer represents a welfare loss to payphone consumers. MCI and other parties have asserted, and the E-Group study discusses in detail, the notion that payphones are locational monopolies and the competition in that industry is to the detriment of the consumers of payphone services, not to their benefit. A recent news story supports the market structure analysis of the E-Group study: "Bell Atlantic said Wednesday it is raising the price of a local call from its pay phones in eight states and Washington, D.C., to $0.35 from $0.25 because of pressure from competitors....Bell Atlantic said it must pay competitive commissions for property owners to place its pay phones in their businesses so it must charge a competitive price to users of those phone (Reuters News, Nov. 12, 1997)."

"estimated an elasticity of demand for payphones (not for coin calls) of -0.31...."[12] This is in fact the coin call price elasticity from the study. It is unclear what the "elasticity of demand for payphones"even means. This elasticity estimate is reasonable and is derived from the equilibrium entry condition used (and clearly set forth) in the E-Group study.

Most importantly, Dr. Hausman fails to acknowledge the primary goal of the E-Group study: an analysis of the consequences to consumer welfare of increases in the rates for payphone services. The E-Group study establishes that increases in the number of payphones due to price increases will be muted, and that the welfare loss to the public per net additional phone is quite substantial. An overall reduction in consumer welfare resulting from a price increase cannot, by definition, be "to the benefit of the general public" as required by the Act.

III. CONCLUSION

Based on the foregoing, MCI requests that the Commission grant AT&T's Petition and deny the Petitions of the Coalition, APCC and Peoples Telephone.

Respectfully submitted,

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Dated: January 7, 1998

[12] The Coalition Petition, Hausman Declaration at 2, note 2.

CERTIFICATE OF SERVICE

I, Sylvia Chukwuocha, do hereby certify that the foregoing Comments was served this 7th day of January, 1998, by hand delivery or first-class mail, postage prepaid, upon each of the following persons:

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